BEFORE THE DEPARTMENT OF ADMINISTRATION
OF THE STATE OF MONTANA

In the matter of the amendment of ARM 2.59.1701, 2.59.1703, 2.59.1705, 2.59.1706, 2.59.1707, 2.59.1709, and 2.59.1710 pertaining to the licensing and regulation of mortgage brokers, mortgage lenders, and mortgage loan originators; the repeal of ARM 2.59.1704, 2.59.1711, 2.59.1712, 2.59.1713, and 2.59.1715; and the adoption of NEW RULES I through VIII regarding license renewals for mortgage lenders as of July 1, 2009; new applicants for a mortgage loan originator license – temporary licenses; new applicants for a mortgage broker or mortgage lender license – temporary licenses; net worth requirement for mortgage brokers; unacceptable assets; proof of net worth; records to be maintained by mortgage lenders and financial responsibility	)	NOTICE OF AMENDMENT, REPEAL, AND ADOPTION

TO: All Concerned Persons

1. On August 13, 2009, the Department of Administration published MAR Notice No. 2-59-414 pertaining to the public hearing on the proposed amendment, repeal, and adoption, of the above-stated rules at page 1292 of the 2009 Montana Administrative Register, Issue Number 15.

2. The department has amended ARM 2.59.1701, 2.59.1703, 2.59.1705, 2.59.1706, 2.59.1707, 2.59.1709, and 2.59.1710 exactly as proposed.

3. The department has repealed ARM 2.59.1704, 2.59.1711, 2.59.1712, 2.59.1713, and 2.59.1715 exactly as proposed.

4. The department has adopted New Rules I (2.59.1718), II (2.59.1719), III (2.59.1720), IV (2.59.1721), V (2.59.1722), VI (2.59.1723), and VII (2.59.1724) exactly as proposed.

5. The department has thoroughly reviewed and considered the comments and testimony received on proposed New Rule VIII. In light of those comments, and the concerns expressed by the mortgage broker industry, the department has redrafted the proposed New Rule VIII in a manner that the department hopes will address the concerns of the mortgage broker industry relative to the use of financial criteria in licensing. The proposed New Rule VIII will be noticed separately for a new

comment period and public hearing separate from this adoption notice, and is not being adopted at this time.

6. The department has thoroughly considered the comments and testimony received. A summary of the comments received and the department's responses are as follows:

Comment 1: Three people commented on ARM 2.59.1701(2) that it is unfair to require a mortgage loan originator to work for one entity.

Response 1: The concept that a mortgage loan originator may work only for a single entity is not new. The 2003 version of the Montana Mortgage Broker and Loan Originator Licensing Act stated, "[a] loan originator may transact business only for an employing mortgage broker licensed in accordance with the provisions of this part." That language existed from 2003 until July 1, 2009 in 32-9-119(1), MCA.

On July 1, 2009, the Montana Mortgage Broker, Mortgage Lender, and Mortgage Loan Originator Licensing Act (Montana Act) took effect. Under 32-9-116, MCA, the Montana Act provides: "[a] mortgage loan originator may transact business only for an employing mortgage broker or one employing mortgage lender licensed in accordance with this provisions of this part."

Since 2003, Montana law has consistently required a mortgage loan originator to work for one employing entity. The Montana Act carries that concept forward.

One person commented that she is an independent contractor who works for several mortgage loan originators. It should be noted that an independent contractor who is a sole proprietor, and is licensed as such, can continue to act as mortgage broker and mortgage loan originator for multiple companies. See the response to comment 8.

Comment 2: One person commented that the net worth requirements of New Rule IV will effectively eliminate her ability to originate mortgage loans. She also commented that mortgage loan originators should not be financially responsible for loans.

Response 2: The net worth option is available only to a mortgage broker entity, not an individual mortgage loan originator. A mortgage broker may elect to carry a surety bond or, in lieu of the surety bond, the mortgage broker entity may elect the net worth option. The election is at the mortgage broker's discretion.

Mortgage loan originators are not financially responsible for loans. They are required to be bonded in order to ensure their compliance with state and federal laws related to the origination of residential mortgage loans. The surety bond is intended to be used to reimburse borrowers, or bona fide third parties, who demonstrate a financial loss due to the acts of a mortgage loan originator, mortgage broker, or mortgage lender. A surety bond or minimum net worth is required by the

Secure and Fair Enforcement for Mortgage Licensing Act of 2008 found in Title V of the Housing and Economic Recovery Act of 2008 (Pub. L. 110-289, 1501-1517, 122 Stat. 2654, 2810-2824 [July 30, 2008]) (federal SAFE Act). It is specifically required in 12 USC 5107(d)(6) and 32-9-123, MCA.

Comment 3: One person commented that the regulations do not affect the banking industry at all.

Response 3: It is true that the rules proposed by the Division of Banking and Financial Institutions do not affect the banking industry. The federal SAFE Act requires that federal regulators that regulate state and national banks and credit unions promulgate regulations to implement the federal SAFE Act. The federal regulators have done so. The rules proposed by the federal regulators will apply to all state and national banks and credit unions. The federal rules as proposed will require the registration of financial institutions and individuals employed by financial institutions who engage in mortgage loan origination activities. The proposed rules can be found at Federal Register, Vol. 74, No. 109, June 9, 2009. It is unknown when the final rules affecting banks and credit unions will be adopted.

Comment 4: One person commented that the Home Valuation Code of Conduct (HVCC) has affected their industry greatly and they were highly offended that the Division of Banking and Financial Institutions has taken no action whatsoever on the HVCC ruling.

Response 4: The HVCC was the result of an agreement made in March 2008 between the Federal Housing Finance Agency (FHFA), the New York State Attorney General, the Federal Home Loan Mortgage Corporation (Freddie Mac), and the Federal National Mortgage Association (Fannie Mae). The FHFA is the federal regulatory authority over Freddie Mac and Fannie Mae.

The New York Attorney General's office conducted an industry-wide investigation into mortgage fraud. On November 7, 2007, Attorney General Cuomo announced he had issued subpoenas to Fannie Mae and Freddie Mac seeking information on the mortgage loans the companies purchased from banks, including Washington Mutual, the nation's largest savings and loan. The subpoenas sought information on the due diligence practices of Fannie Mae and Freddie Mac as well as their valuations of appraisals.

As a result of that investigation, Fannie Mae and Freddie Mac entered into an agreement with Attorney General Cuomo. The agreement established the HVCC, created the "Independent Valuation Protection Institute," a new organization to implement and monitor the HVCC, and required all lenders, including banks, to represent and warrant that appraisals related to mortgage loans originated on or after January 1, 2009, conform to the HVCC. Any mortgage loan based on an appraisal that does not conform to the HVCC will not be purchased by Fannie Mae or Freddie Mac.

Fannie Mae and Freddie Mac held an open comment period from March 14 through April 30, 2008. As a result of the comments received, the HVCC was revised and a new effective date of May 1, 2009, for the revised code. As of May 1, 2009, Fannie Mae and Freddie Mac will not purchase a loan that was not made in conformance with the HVCC.

The HVCC prohibits a mortgage broker from ordering an appraisal, or selecting, retaining, or providing payment to an appraiser. Any questions or concerns regarding the HVCC should be directed to Fannie Mae, Freddie Mac, or the FHFA who are responsible for implementing the HVCC.

The Montana Division of Banking and Financial Institutions has no jurisdiction over any of the parties involved in the HVCC, was not involved in any way in the HVCC, and has no authority to take any action on the HVCC.

Comment 5: The Montana Association of Mortgage Brokers and their attorney commented that the federal SAFE Act only addressed independent contractors in reference to loan processors or underwriters, not mortgage loan originators. So, the matter should be left to the Department of Labor and Industry, not the banking division, to determine whether a mortgage loan originator should be considered an independent contractor or an employee.

Response 5: The federal SAFE Act states, "[a]n independent contractor may not engage in residential mortgage loan origination activities as a loan processor or underwriter unless such independent contractor is a State-licensed loan originator." 12 USC 5103(b)(2). This section applies to independent contractors who engage in residential mortgage loan origination activities.

That language is also found in 32-9-129(2), MCA. It requires an independent contractor who engages in mortgage loan origination activities to be licensed as a mortgage loan originator. The section makes no mention of "employee."

For the analysis of Montana law in relation to an employee, see response 6.

Comment 6: Three people commented on ARM 2.59.1701(2) that it is unfair and unreasonable to require independent contractors to be employees. Independent contractors are able to set their own hours, pay, and benefits. One person commented that she "employs" loan originators as independent contractors, which allows her to give a job to people without the expense of a salary, benefits, and a bookkeeper.

Response 6: The Montana Act was passed by the 2009 legislature in order to implement the provisions of the federal SAFE Act. The federal SAFE Act requires each mortgage loan originator to carry a surety bond that is scaled to their loan production volume. The federal SAFE Act applies only to individuals and it requires each individual licensed to carry a surety bond.

In Montana, mortgage broker entities, in addition to individuals, have always been licensed. The Model State Law, which was developed by the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators, and approved by the U.S. Department of Housing and Urban Development (HUD), provides:

> [e]ach mortgage loan originator shall be covered by a surety bond in accordance with this section. In the event that the mortgage loan originator is an employee or exclusive agent of a person subject to this Act, the surety bond of such person subject to this Act can be used in lieu of the mortgage loan originator's surety bond requirement.

That language is repeated nearly verbatim in 32-9-123(1)(a), MCA.

So, despite the fact that federal SAFE Act requires each individual to carry a surety bond, the Model Law and Montana law allow the surety bond to be maintained by the entity, but only if the mortgage loan originator is the employee or exclusive agent of the entity. HUD approved the Model Law. HUD has ultimate authority to issue rules to interpret the federal SAFE Act and to determine whether each state's laws and rules are in compliance with the federal SAFE Act.

HUD has proposed rules to implement the federal SAFE Act. The rules were proposed on December 15, 2009. The comment period on the HUD proposed rules runs until February 16, 2010. HUD has proposed to define "employee" under the federal SAFE Act as follows:

> (1) Subject to paragraph (2) of this definition, [employee] means:
> (i) An individual:
> (A) Whose manner and means of performance of work are subject to the right of control of, or are controlled by, a person, and
> (B) Whose compensation for Federal income tax purposes is reported, or required to be reported, on a W–2 form.
> (2) Has such binding definition as may be issued by the Federal banking agencies in connection with their implementation of their responsibilities under the SAFE Act.

Montana's proposed definition of "employee" is consistent with HUD's proposed definition of "employee."

In order for an individual mortgage loan originator to be covered under the entity's bond, the entity must be responsible for the acts of the individual employee. If the individual is an independent contractor, they are not, by definition, subject to control and supervision by the entity. An independent contractor is not an employee.

In Montana, an independent contractor must obtain an independent contractor certification under 39-71-417, MCA. In order to obtain that certification, the applicant for an independent contractor certification must swear to and acknowledge that the

applicant: "has been and will continue to be free from control and direction over the performance of the person's own services, both under contract and in fact; and that the applicant is engaged in an independently established trade, occupation, profession, or business and will provide sufficient documentation of that fact to the department [of labor]." This is required in 39-71-417, MCA.

Therefore, in order to use the surety bond of the entity, the mortgage loan originator must be the employee of the entity, meaning a W-2 employee, not an independent contractor.

However, 32-9-123(1)(a), MCA, also states a mortgage loan originator may be the exclusive agent of a licensed mortgage broker or lender entity. The department interprets 32-9-123(1)(a), MCA, to mean that if an individual must be licensed under 32-9-113(1), (2), or (3), MCA, that individual is an exclusive agent of the entity and is covered under the entity's surety bond.

It should be noted that due to a drafting error, 32-9-113, MCA, states that individuals who are ultimate equity owners, control persons, or principals of an entity must independently meet the requirements of 32-9-120(1)(a) through (1)(d), MCA. (Emphasis added.) Section 32-9-120(1)(d), MCA, requires the individuals to carry a surety bond. It does not make sense for ultimate equity owners, control persons, or principals to carry a surety bond because they do not originate loans on the entity's behalf. The section that was intended to be referenced was 32-9-120(1)(g), MCA, which prohibits an individual from being licensed if they make a material misstatement of fact or a material omission of fact. Due to a drafting error in the legislative process, the wrong subsection of 32-9-120, MCA, was referenced. The department will introduce legislation in the next legislative session to correct this error.

Comment 7: One person commented that existing rules already subject exclusive independent contractors to sufficient control and supervision by the mortgage broker. This person proposed that the definition of employing in ARM 2.59.1701(2) be amended to read:

(3) "Employing" means the entity for whom the individual works is:

(a) liable for withholding taxes pursuant to Title 26 of the United States Code; or

(b) accountable for the regulated mortgage loan activities of its independent contractors as evidenced by

(1) an executed undertaking of accountability; and

(2) an exclusive written agreement between the sponsoring broker and its independent contractors, such that the independent contractors may broker loans only through the sponsoring mortgage broker or lender.

Response 7: Existing rules are being amended by this notice due to the changes in the law arising from the federal SAFE Act and the Montana Act. The former rule text in ARM 2.59.1701, provided:

(3) "Employed by" means:

(a) an individual performing a service for a mortgage broker liable for withholding taxes pursuant to Title 26 of the United States Code; or

(b) any individual acting as an independent contractor for a mortgage broker if that individual is under exclusive written agreement to broker loans only through their sponsoring mortgage broker or if the sponsoring mortgage broker undertakes accountability for the regulated mortgage loan activities of the independent contractor.

The former rule text is no longer consistent with statute or HUD's proposed rules. That is why the rule is being amended. Given that the Montana Act requires a mortgage loan originator to be an employee or an exclusive agent for a licensed mortgage broker or lender and requires the mortgage broker or lender to be responsible for the conduct of its designated manager and mortgage loan originators, the concept of an independent contractor is no longer consistent with the Montana Act.

The language suggested is not consistent with the Montana Act. The Montana Act requires a mortgage lender or mortgage broker to apply for a branch office license at each location where business is conducted and to designate a separate designated manager for each location. The designated manager is responsible for the operation of the business at the location under the designated manager's full charge, supervision, and control. The mortgage broker or lender is responsible for the conduct of its designated managers and mortgage loan originators.

In order to be an independent contractor, the independent contractor must certify that he or she is free from control and direction over the performance of the person's own services, both under contract and in fact. A person employed by a mortgage broker or lender cannot make this certification and comply with the Montana Act.

Comment 8: One person commented that since mortgage brokers are entities and independent contractors cannot be licensed as individuals, then independent contractors cannot work in the business at all.

Response 8: This is not a correct interpretation of Montana law. A mortgage broker is indeed an entity. A mortgage lender is also an entity. However, "entity" is defined to include a sole proprietorship as provided in 32-9-103(11), MCA. Therefore, a sole proprietor who is independently engaged in business can and should be licensed as a mortgage broker or mortgage lender and as a mortgage loan originator working for their sole proprietorship. This enables the individual to act as an independent contractor for other mortgage broker or lender entities.

Comment 9: One person commented that it should be made clear in rule that the intent of 32-9-123, MCA, was to provide net worth as an option to a surety bond. He feels it should be made clear in New Rule IV that the net worth is an alternative to a

surety bond and the net worth can be met by being FHA approved or as provided by rule if the applicant is not FHA approved.

Response 9: Section 32-9-123, MCA provides, in relevant part:

> (2) (a) A mortgage broker or mortgage lender is required to maintain one surety bond for each entity license.
> (b) The amount of the required surety bond must be calculated by combining the annual loan production amounts for all persons originating residential mortgage loans and for all business locations of the mortgage broker or mortgage lender and must be in the following amount:
> (i) $25,000 for a combined annual loan production that does not exceed $50 million a year;
> (ii) $50,000 for annual loan production of $50 million but not exceeding $100 million a year; or
> (iii) $100,000 for annual loan production of more than $100 million a year.
> (3) (a) In lieu of a surety bond, a mortgage broker may meet a minimum net worth requirement.
> (b) Minimum net worth must be maintained in an amount determined by the department that reflects the dollar amount of loans originated.
> (c) The department shall adopt rules with respect to the requirements for minimum net worth as are necessary to accomplish the purposes of this part.
> (4) Evidence that a mortgage broker is approved by the department of housing and urban development to originate loans insured by the federal housing administration must be considered as satisfying the net worth requirement provided that the actual net worth determined in the department of housing and urban development's approval is equivalent to the bond amount set forth for the corresponding dollar amount range set forth in subsections (2)(b)(i) through (2)(b)(iii).

The text of the statute makes it clear that a mortgage broker may meet a minimum net worth requirement in lieu of a surety bond. The statute also makes clear that evidence of a HUD certification must be considered as satisfying the net worth requirement provided that the HUD approval is equivalent to the bond amount set forth in 32-9-123(2)(b)(i) through (iii), MCA. Rules may not unnecessarily repeat the statutory language as provided in 2-4-305(2), MCA. Therefore, the department cannot repeat the language of the statute in rule.

By: /s/ Janet R. Kelly
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By: /s/ Michael P. Manion
Michael P. Manion, Rule Reviewer
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Certified to the Secretary of State February 1, 2010.